RESEARCH HIGHLIGHTS

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THE HOUSING CONSTRUCTION INDUSTRY: CHALLENGES AND OPPORTUNITIES FOR THE 21ST CENTURY

Introduction

This study examines the evolution of the new house building and renovation construction industry in Canada during the 1990s, the industry's current and future challenges in the period to 2010 and the opportunities for the industry to respond to those challenges. Within this context it looks at the structure of the industry and the influences of a variety of external factors.

The focus is the private sector. Public sector activity, namely federal, provincial/territorial and municipal government involvement in social housing construction and delivery, is not covered in the paper.

Topics discussed include:

- the structure of the industry: understanding how the industry is organized and how it functions is a major element in comprehending how external factors affect the industry and how the industry will meet future challenges; and,
- external factors that have both short- and long-term effects on the industry: identifying the major trends in areas such as demographics, the economy, regulation, technology; these are important when considering what the future may be like for the industry.

The final section of the paper assesses the challenges and opportunities the industry will face over the next decade.

Objectives and Methodology

The study approach included a literature review, data gathering and analysis, and a consultation process involving housing industry stakeholders. Where studies were available on particular issues, these have been summarized and referenced. However, where studies were not available, only the views of informants have been discussed.

The consultation process—a significant component of the project—was designed to obtain stakeholder's reaction and comment on a series of views on recent and future trends in the residential construction industry. The countrywide sample of respondents included a cross-section of industry interests. A total of 60 interviews were completed between the end of January and mid-March 2001. Of these, 47 were lengthy personal interviews and sometimes involved a small group of up to four people at the suggestion of the industry stakeholder. The remaining interviews were in-depth phone interviews.

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Findings

Structure of the Industry

Highlights of trends in the 1990s include:

- The residential construction industry in Canada contributes over five per cent to Canada's Gross National Product and provides almost one million person-years of employment, directly and indirectly every year.
- The industry comprises almost 75,000 firms of which single family builders account for almost half (34,900 firms), land developers and renovators for about one-quarter each (19,300 and 17,500 firms respectively), and apartment builders for the rest (2,700 firms). About two-thirds of all firms are unincorporated.
- In 1997, the proportion of profitable firms in the residential construction industry was generally higher than that in the economy as a whole, although the absence of comprehensive data means that such comparisons must be interpreted cautiously.
- In terms of employment levels, most firms are small, with an average of fewer than two paid employees per firm. Almost 40 per cent of total employment is attributable to one province—Ontario.

Emerging trends in the 2000s

The structure of the industry is unlikely to change much in the first decade of the 2000s.

The industry is so large, complex and locally-focused that changes will of necessity be incremental and evolutionary, not radical or revolutionary. That being said, the industry is facing many significant challenges such as labour force shortages, increased regulation, environmental concerns and pressures on profit margins.

Demographic Factors

Highlights of trends in the 1990s include:

- While household sizes declined steadily, the average size of new homes did not decrease, due possibly to increasing income levels for some Canadians and consumer expectations.
- There was a steady decline in the home ownership (non-condominium) rate for household maintainers under the age of 30 years, and an increasing interest in rental and condominium ownership housing options by younger households.
- The impact of immigration trends on housing markets has been considerable, particularly in the three largest CMAs where most immigrants settle—Toronto (42 per cent), Montréal (15 per cent), or Vancouver (16 per cent). The development of new intergenerational housing options such as "bi-family" or "2 plex" housing was a trend that emerged in the larger cities.

Emerging trends in the 2000s

The decline in household formation will be gradual over the next 10 years, and the origin of new households is expected to be more dependent on immigrants than on natural increase.

Baby boomers will continue to be the dominant demographic group in the population. The first of the baby boomers turn 65 in 2012 (after the time horizon for this project). The peak years of the baby boom were between 1955 and 1964 and people born then do not turn 65 until 2020 at the earliest.

For the housing industry, the baby boom echo (the children of the boomers) is an important group over the next 10 years as they form households and become first-time buyers.

Immigration is becoming an increasingly important component of population growth and this trend will continue over the next 10 years. The demographic profile of new immigrants will greatly influence the type of housing required. Immigrant households will continue to look for more flexibility in housing design and planning to take into account diverse household types, including extended families and intergenerational living arrangements.

The demand for affordable housing will increase, including growing demand for rental accommodation. Reasons for this include the economic insecurity of the workplace for some groups and increasing student debt loads experienced by the "bust" generation. The increasing pressure on the rental market—especially the low end of the market, is creating demand for accessory apartments, co-residency housing and other forms of affordable rental housing.

The indications are that over the next decade, Canadians of all generations are going to be looking for a range of housing choices involving design, financing and tenure options, including alternative tenure arrangements. While the largest segment of the market will be geared to the varied housing needs of aging Canadians, there

will be challenges in meeting the housing needs of younger and diverse population groups which are likely to involve digressing from traditional housing types and tenure patterns.

Economic Factors

Highlights of trends in the 1990s include:

- The number of housing starts was extremely volatile over the period, ranging from a low of 110,933 in 1995 to a high of 181,630 in 1990.
- Fluctuations in full-time employment levels contributed to this volatility. The number of full-time jobs in Canada plunged during the recession of the early 1990s and did not begin to recover until 1993. Healthy job growth in the latter stages of the decade resulted in stronger housing markets in most of the country.
- One of the links between job growth and housing markets is the impact of employment patterns on income. Real per capita disposable income fell for much of the decade and only began to recover in 1997. Sluggish income growth may have been the single most important factor behind the weakness in housing starts in the 1990s.

Emerging trends in the 2000s

Overall, the 1990s were not that positive a decade for the nation's housing markets—there were significant contractions in many parts of the country. In many respects, the 2000s appear to be more promising—interest rates are relatively low and may remain that way, productivity levels continue to improve, immigration is expected to be robust, and income growth is likely to be stronger in the 2000s than in the 1990s.

Regulatory Factors

Building Regulation

Highlights of trends in the 1990s include:

- Builder licensing was introduced in Quebec and British Columbia (Ontario has had a de facto licensing structure for years because all builders must be registered with the Ontario New Home Warranty Program).
- Mandatory home warranties in Ontario were joined by similar programs in Quebec and British Columbia.
- Concerns about liability grew over the decade, caused in part by court decisions increasing the potential liabilities faced by new home builders and renovators. The courts have also found municipal inspectors liable for negligence in plan examination or building inspections.
- The groundwork has begun for a big change to building codes with the creation and use of more flexible objective-based codes intended to encourage innovative approaches to construction. The first edition of an objective-based code is expected in 2003.

Emerging trends in the 2000s

The role of regulation in the residential construction industry is a highly complex matter. There is a demand among builders for regulatory reform which recognizes, supports and rewards varying degrees of professionalism in the industry. Builder occupational licensing and mandatory warranties are expected to become more important throughout the country in the future.

The industry has expressed interest in Australian style reforms (mandatory licensing and warranties, privatization of building approvals and limitations on liability) as an appropriate direction for the Canadian industry to follow. As well, Ontario's Building Regulatory Reform Advisory Group (BRRAG) has suggested many reforms to Ontario's building regulatory environment which were enacted in June 2002 and will take effect in 2004.

Land Use Regulation Issues:

Highlights of trends in the 1990s include:

Concerns about sustainability and economic factors related to the escalating cost of infrastructure influenced housing markets in the 1990s. The move to more sustainable urban development generated opportunities for creative design for infill and higher density housing, and was supported by increasing use of innovative regulatory tools.

Emerging trends in the 2000s

In the 2000s, as population growth continues, it is anticipated that smart growth (sustainable development) practices will become increasingly common and increasingly expected.

Environmental Regulations:

Highlights of trends in the 1990s include:

In the 1990s, concern for the environment grew and federal and provincial/territorial governments introduced a number of regulatory measures focused on environmental protection of land, air and water.

Emerging trends in the 2000s

During the 2000s, conservation and environmental protection will continue to be of critical concern, with environmental regulations becoming increasingly important.

There is a concern within the industry that the existing land contamination standards are impractical and obstruct the clean up of contaminated lands and brownfield sites. The availability of best practices material on decommissioning contaminated sites and modifications to regulations have the potential to open up intensification opportunities for innovative development in existing urban areas. Brownfield development (the revitalization of idle industrial sites) is becoming increasingly key to urban redevelopment.

Mortgage Financing

Highlights of trends in the 1990s include:

- Over the last decade mortgage lending has evolved considerably: mortgages were made more flexible and more competitive; new instruments were increasingly being used to respond to new market demands such as the reverse mortgage.
- Financial institutions increasingly regenerated their mortgage funds on the secondary mortgage markets, while CMHC's Canada Mortgage Bonds opened up new investment opportunities for investors and expanded the pool of capital available to fund mortgages, keeping interest rates lower than otherwise would be the case.
- A new intermediary appeared on the market in the early nineties: the mortgage broker.
- During the last decade chartered banks increased their market share to 59 per cent of all mortgage credit in 1999 from 52 per cent in 1995, while trusts and mortgage loan companies' and life insurance companies' share fell.
- Bad credit experiences during the early 1990s made lenders more selective. The impact of credit tightening on the construction industry resulted in increased difficulty in obtaining construction loans to build homes on speculation.
- In 1992, tax policy changes enabled first-time homebuyers to withdraw money accumulated in their RRSP in order to help in the purchase of a home. The plan has facilitated an estimated 527,000 home purchases, about 75,000 of which occurred in the year 2000.
- Since 1996, faster mortgage approvals and lower costs became possible with the introduction of CMHC's **emili**, an automated risk and mortgage assessment system.
- Mortgage interest rates fell almost without interruption during the 1990s. Home ownership became increasingly affordable and helped to increase the level both of new construction activity as well as home renovation, causing lenders to look for new ways to offer their services.
- More knowledgeable and better educated consumers tend to be more demanding in their selection of finance products and options offered by builders and lenders, encouraging increased competition and more shopping before committing to purchasing a financing product.

- Internet use by financial institutions to promote their services and mortgage products was a trend started in the 1990s. Consumers also started using the Internet to shop for rates, although actual transactions were still being done in a face-to-face situation.

Emerging trends in the 2000s

In the 2000s, continuing changes in the financing system will likely be associated with wider choice, fiercer competition and greater use of electronic media and the Internet in mortgage financing. Borrowers will benefit from a wider range of options available to repay the mortgage to suit their individual needs.

Consultation with survey respondents confirmed that the trends initiated in mortgage financing in the early nineties will continue. Nearly 84 per cent of those consulted were of the view that, over the next 10 years, there will be further innovations in the residential mortgage industry.

Mortgage brokers will become increasingly important over the next few years.

As Internet transactions will become more prevalent and more secure, it is possible that a larger portion of the mortgage approval process will be completed over the Internet.

The construction industry is likely to benefit from generally lower rates resulting from increased competition among lenders, the advent of mortgage brokers, and lenders taking advantage of the opportunity to obtain low-cost financing through the sale of mortgages in their portfolios on the secondary mortgage market.

Trade and Labour Mobility

Highlights of trends in the 1990s include:

- In Canada, barriers among provinces started to slowly disappear in the 1990s with the reduction or elimination of many trade restrictions among provinces. The Agreement on Internal Trade (AIT), which came into effect in 1995, is directed at making it easier for people, goods and services to move across Canada. In addition, an agreement was signed in 1996 between the governments of Quebec and Ontario aiming to encourage construction labour mobility between the provinces.
- An encouraging sign by the end of the 1990s was that contractors and suppliers could quote on government calls for tenders from outside their province of residence. This had been unthinkable previously.
- In spite of the North American Free Trade Agreement's (NAFTA) objectives of encouraging free trade and greater work force mobility among countries, both Canada and the U.S. employ policies which do not allow construction workers from outside their jurisdictions to work in each other's country without long, complicated and often unsuccessful applications.
- Trade barriers that existed at the beginning of the 1990s were being dismantled by the end of the decade. However, some U.S. restrictive policies still remain, such as those affecting softwood lumber.

Emerging trends in the 2000s

In spite of governments' collaboration in removing barriers to worker mobility among provinces, the implementation of full mobility, especially with Quebec, is far from complete and remains a challenge for the coming decade. The next 10 years will undoubtedly see the continuation of the movement to remove obstacles to labour mobility among provinces and countries.

The construction industry will continue to make representations to improve mobility among provinces. Eventually mobility may come to be seen as part of the solution in order to fill shortages of skilled people in specialized construction trades. Factors in favour of improved mobility will be the increasing shortage of skilled people in the construction industry and the increased free trade among countries in the Americas. The factors constraining change will still be protectionist measures by governments and unions.

The elimination of labour mobility barriers in most provinces has been positive for the industry, opening up opportunities for construction trades to move between jurisdictions. For an industry facing skilled labour shortages, greater labour mobility and reliance on immigration to increase the number of skilled workers offer a partial solution to the problem.

Development Cost Charges, Taxes, Fees and Construction Costs

Highlights of trends in the 1990s include:

- Over the last decade provincial governments have offloaded many responsibilities to local governments, including greater responsibility for infrastructure provision.
- Faced with the need for revenue, and wanting to constrain increases in the property taxes of existing residents, the trend in the 1990s was for local governments to opt for a user pay policy which increased development cost charges (DCCs) or levies on new residential development to cover servicing costs.
- In Ontario, charges were relatively stable through the 1990s. In contrast, charges in municipalities in the Lower Mainland of British Columbia increased from a range of $500 - $900 for a new single family home in the late 1980s to generally over $15,000 by the late 1990s; an increase many times the rate of inflation.

Emerging trends in the 2000s

The trend will likely be for provincial governments to continue to offload responsibilities to the local level. Municipalities, however, have expressed the concern over their financial capacity to take on these new responsibilities under existing revenue-generating mechanisms.

A number of municipalities and urban planners are starting to re-assess the application of DCCs, not only from the perspective of their impact on urban form and relationship to smart growth policies, but also as a revenue generator. Whether DCCs continue to play the role they did in the last decade, or whether alternate sources or means of funding infrastructure will emerge, it will have implications for the housing industry in its ability to produce homes priced for consumers in their respective markets.

Technology

Application of Innovative Technology and Practices:

Highlights of trends in the 1990s include:

- The residential construction industry witnessed a number of innovations that improved the production process for housing in the 1990s. Areas of innovation included: energy-efficiency measures, foundation systems, roofing and the building envelope.

Emerging trends in the 2000s

Over the next decade, the move to objective-based codes has significant potential implications for encouraging innovation in the new house building and renovation construction industry in Canada.

Application of E-Commerce Technology:

Highlights of trends in the 1990s include:

- The biggest technological change of the last 10 years has been the rapid development of the Internet and the way it has changed business strategy and investment, as well as consumer access to information.

Emerging trends in the 2000s

In the 2000s the Internet will play an increasingly significant role in delivering information and services to the new house building and renovation construction industry. Decreasing hardware costs will alleviate the cost concerns for smaller firms.

Challenges and Opportunities

Having identified a number of issues that will affect the housing industry in Canada over the next decade and beyond, it is expected some established trends will continue to develop and new trends will emerge that will require the housing industry in Canada to adapt. The concluding section of the report highlights the challenges and opportunities these trends present for the housing industry.

Areas discussed relate to:

Data Availability: The inadequacy of available data sources, and lack of thorough analyses for profitability for unincorporated firms, which are very common in the industry, all make it challenging to identify and address problems.

Demographic Factors: An aging population with an increasing propensity to remain as homeowners, younger generations facing less job security and looking for flexibility and diversity in housing, tenure and financing options, and an increasing trend to multi-generational households and related housing needs will present the industry with challenges to respond with diversity, flexibility and affordability in design, construction, renovation, financing and tenure options.

Economic Factors: There is indication that some components of the housing industry may be less profitable than the average Canadian business, but because of data availability problems, it is difficult to know what the situation is with regard to industry profitability and whether or not profitability trends are worsening or improving. In addition, the growing shortage of skilled labour in the Canadian housing industry if not addressed will continue to impair the ability of firms to respond to demand, and the cost of housing could increase in the future because of this.

Regulatory Factors: Builders and other stakeholders in the housing industry are becoming increasingly concerned about the nature and extent of the liabilities they face as a result of building or renovating houses. The regulatory framework governing the Canadian housing industry is evolving rapidly. Some aspects are welcomed by the industry and some are viewed with extreme concern.

Mortgage Financing: Home financing arrangements are becoming more varied, flexible and innovative. Lenders are introducing products that respond to a variety of needs and are mutually beneficial to lender and client.

Trade and Labour Mobility: Labour shortages could impair the ability of firms to respond to demand and affect the cost of housing. The industry faces the challenge of attracting more young people into the profession as the existing baby-boom workforce ages. With labour shortages becoming more acute, increasing standardization and supporting trade mobility among provinces becomes important. There is also the challenge of mobility of skilled workers across the U.S./Canada border.

Development Cost Charges: With an increasing variety of levies, user fees and taxes pushing up the cost of new home construction there is pressure to examine alternative revenue generating mechanisms to provide for capital works infrastructure.

Technology: Innovative practices appear poised to emerge in the future; however, there continues to be a number of barriers both within and outside the industry to innovation.

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Research Report: *The Housing Construction Industry: Challenges and Opportunities for the 21st Century*

Research Consultant: Urban Aspects Consulting Group Ltd. and Langlais et associés

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